



# **STATE OF NORTH CAROLINA**

**NORTH CAROLINA DEPARTMENT OF HEALTH  
AND HUMAN SERVICES**

**STATEWIDE FINANCIAL STATEMENT AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2010**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**NORTH CAROLINA DEPARTMENT OF HEALTH  
AND HUMAN SERVICES**

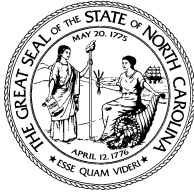
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State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet  
<http://www.ncauditor.net>

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**AUDITOR'S TRANSMITTAL**

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The Honorable Beverly Eaves Perdue, Governor  
Members of the North Carolina General Assembly  
Lanier M. Cansler, Secretary  
North Carolina Department of Health and Human Services

We have completed certain audit procedures at the North Carolina Department of Health and Human Services related to the State of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2010. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts, and grants applicable to the State's financial statements. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

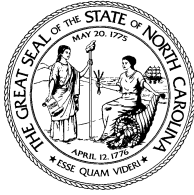
Our audit objective was to render an opinion on the State of North Carolina's financial statements and not the Department's financial statements. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

The audit finding referenced in the report will also be evaluated to determine its impact on the State's internal control and the State's compliance with rules, regulations, contracts and grants. If determined necessary in accordance with *Government Auditing Standards*, this finding will be reported in the State's *Single Audit Report*.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor



**Beth A. Wood, CPA**  
State Auditor

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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Secretary Lanier M. Cansler  
and Management of North Carolina Department of Health and Human Services

As part of our audit of the State of North Carolina's financial statements, we have audited selected elements of the North Carolina Department of Health and Human Services' financial statements, as of and for the year ended June 30, 2010. Our report on the State of North Carolina's financial statements is included in the State's *Comprehensive Annual Financial Report*. Our financial statement audit scope at the North Carolina Department of Health and Human Services included the following:

- General Fund, excluding the Division of Mental Health, Developmental Disabilities and Substance Abuse Services

The audit results described below are in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the State's financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
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and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, we consider the deficiency described in the Audit Findings and Responses section of this report to be a material weakness in internal control over financial reporting, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Management's response to the finding identified in our audit is included in the Audit Findings and Responses section of this report. We did not audit the response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Secretary, the Department's Audit Committee, others within the entity, the Governor, the General Assembly, and federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA  
State Auditor

December 8, 2010

## AUDIT FINDINGS AND RESPONSES

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### **Matters Related to Financial Reporting**

The following finding and recommendation was identified during the current audit and discusses a condition that represents a deficiency in internal control.

#### DEFICIENCY IN FINANCIAL REPORTING

The year-end financial information prepared by the Department and submitted to the Office of the State Controller contained a material misstatement that was corrected as a result of our audit. The misstatement indicates that the Department's internal control over financial reporting was not effective, and without our correction, the State's financial statements could have been misleading to readers.

The federal Supplemental Nutrition Assistance Program uses an electronic benefits transfer system to make it possible for program beneficiaries to charge their qualifying food purchases. Revenues and expenditures are then reported by the Department equal to the underlying food purchases.

The Department incorrectly made an adjusting journal entry to eliminate \$2 billion in previously recorded revenues and expenditures related to electronic benefit transfer payments for the year ended June 30, 2010. The adjusting journal entry was prepared and approved by the same staff person, which bypassed established review procedures. The Department is responsible for the fair presentation of its financial information; therefore, it is essential that effective internal control over financial reporting be in place and operating to provide reasonable assurance regarding the reliability of financial reporting.

*Recommendation:* The Department should ensure that established internal control procedures are followed to ensure the completeness and accuracy of the information submitted to the Office of the State Controller for inclusion to the State's financial statements.

*Department Response:* The Department concurs with the finding. The error occurred when a staff person inadvertently eliminated the balance in a revenue account without full knowledge of the reversing entry and failed to follow written journal entry review procedures prohibiting journal entries from being prepared and approved by the same person. The significance of adhering to established review procedures has since been communicated to the appropriate staff. In addition, beginning with the compilation of information for the 2010-2011 Comprehensive Annual Financial Report (CAFR), the Department plans to implement additional levels of review for large CAFR journal entries and for changes in balances at the division level. These additional internal controls should help to ensure the completeness and accuracy of the CAFR information. The additional levels of review will be identified and implement prior to work on the next CAFR.

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